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Sent via email: regcomments@ncua.gov

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Mary Rupp, Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: Marvin Umholtz Comments on Notice of Proposed Rulemaking for Part 704 -- Corporate Credit Unions (Affecting 12 CFR Parts 701, 704, and 741 published in the *Federal Register* 11/ 29/10)

Dear Ms. Rupp:

I appreciate having the opportunity to present these comments to the members of the National Credit Union Administration (NCUA) Board about the proposed rulemaking setting forth additional rules affecting corporate credit unions. The opinions in this comment letter represent my point of view and are not necessarily the views held by any of my clients or by any organization with which I may be affiliated. I have no corporate credit unions for clients and do not have a stake in whether they continue to exist or not. Similarly, I have no non-federally insured credit unions or other non FICUs as clients, but oppose their questionable treatment under this proposed new §704.21 based upon the public policy principles and underlying fundamentals of commerce that are breached. It is difficult to clearly see how these proposed restrictive rules would better ensure safety and soundness for corporate credit unions or retail credit unions. In the absence of such clarity, the NCUA Board should instead choose to do no harm.

NCUA Board Expanded Its Fix for Corporate Credit Unions with More Micro-Managing Rules
During its November 18, 2010 open meeting, the NCUA Board took additional steps to implement its fix for the corporate credit union situation – including more proposed rules. As explained in the NCUA's *Board Action Bulletin*, "The proposals would require corporates to establish new internal control reporting requirements and establish an enterprise-wide risk management committee staffed with a risk management expert, conduct all board of director votes as recorded votes, and disclose certain CUSO [credit union service organization] compensation received by employees who are dual employees of corporates and corporate CUSOs. The proposed amendments also provide for the equitable sharing of Temporary Corporate Credit Union Stabilization Fund [TCCUSF] expenses among all members of a corporate and permit a corporate to charge reasonable one-time or periodic membership fees. In addition, the proposal would amend 12 C.F.R. Parts 701 and 741 to limit natural person credit unions to membership in one corporate at a time."

According to NCUA, the amendments were issued with a 30-day comment period with a final rule expected early in 2011. Subsequent to the November 29th publication in the *Federal Register*, the comment period was extended to 60 days. These additional proposed rules leave little doubt that the NCUA Board intends to micro-manage any corporate credit unions that remain standing once this all shakes out. The NCUA Board is expected to draw criticism for several of the new rules, especially the one limiting retail credit union membership in only one corporate credit union. The "one corporate" rule is designed to limit risk and rate shopping, but seems awfully paternalistic with its establishment of a government-controlled marketplace. If such a rule is needed to manage risk, then perhaps a "zero corporate" rule would be more appropriate by removing all of the potential risk.

The proposed membership fee authority serves a valid purpose to encourage building retained earnings, but it adds unneeded restrictions when it should instead let any corporate credit union decide the nature of the fee, if any, it chooses to impose. Many will find the CUSO compensation disclosure proposal discomforting, but not fatally so. The risk management protocols and internal controls are probably good ideas. However, the absolutely worst example of bureaucratic myopia embodied by these proposals is the misguided attempt to impose "equitable sharing" of TCCUSF expenses.

"Equitable Sharing" Proposal Represents Government Run Amok

The explanation about the "equitable sharing" provided in the NCUA's *Board Action Memorandum* (BAM) supporting the proposed rule was in itself an illustration of government run amok – not to mention circular logic. As the BAM explained it, "Some of the recent corporate investment losses were absorbed directly by the members of the corporate in the form of capital depletion. Much of these losses, however, were absorbed by the NCUSIF [National Credit Union Share Insurance Fund] as it made capital injections and launched liquidity and share guarantee programs designed to stabilize the corporate system and protect the system from collapse. The corporate losses absorbed by the NCUSIF – and subsequently transferred from the NCUSIF to the TCCUSF in June of 2009 and 2010 – will be paid by all FICUs [federally insured credit unions] in the form of premium assessments now and over the next several years."

The NCUA BAM continued, "The stabilization actions taken by NCUA to protect the corporate system benefitted *every* member of *every* corporate, both FICU and non FICU [the *every* emphasis was NCUA's]. Without the NCUA's stabilization actions, the entire corporate system would have been in danger of collapse. NCUA's actions protected both FICUs and non FICUs from potential losses in their uninsured shares and from other potential problems, such as interruptions in their payment systems. Unfortunately, however, not all corporate members have assumed their fair share of the expense of NCUA's corporate stabilization actions. In particular non FICU members have not paid, and likely will not pay in the future without some encouragement, their fair share of the expenses associated with NCUA's stabilization actions. Accordingly, and as discussed below, this proposal seeks to encourage existing non FICU members to pay their fair share of such expenses." In a footnote the BAM explained, "The term 'non FICU' includes every corporate member that is not insured by the NCUSIF. Trade associations, CUSOs, non credit union cooperatives, banks, insurance companies, and privately insured credit unions are examples of entities that might be members of certain corporates and fall within the term 'non FICU.'"

Then came the NCUA BAM's kicker, "The proposal adds a new §704.21, *Equitable distribution of corporate credit union stabilization expenses*, to provide for the equitable sharing of TCCUSF expenses among all members of corporate credit unions. Proposed §704.21 provides that when the NCUA Board assesses a TCCUSF premium on FICUs, NCUA will request existing non FICU members make voluntary payments to the TCCUSF. It requires that when the NCUA Board imposes a TCCUSF on FICUs, a corporate credit union must furnish to NCUA information about all its non FICU members. NCUA will then request each of these non FICU members to make a voluntary premium payment to the TCCUSF in an amount calculated as a percentage of the non FICU member's previous year-end assets. In the event one or more of these non FICUs declines to make the requested payment, or makes a payment in an amount less than requested, the proposal requires the corporate conduct a member vote on whether to expel that non FICU."

The BAM continued for another page and a half describing the details of this questionable and agency-embarrassing proposed rule. If the NCUA Board wants to make it even more likely that corporate credit unions won't succeed, this is a good tactic to achieve that end. Such a counterproductive rule from the primary credit union insurance regulator adds to the damaging perception of risk. Where is Suze Orman when the NCUA Board really needs her the most? Perhaps even she would have trouble explaining the safety and soundness value supposedly achieved by this proposal.

Voluntary Gift Could Potentially Lead to Stakeholder Complaints or Lawsuits

I also found it difficult to imagine that any non FICUs would make such a voluntary gift to the NCUA – and if they did someone should send the men in white coats to take them to the loony bin. As historic corporate credit union non FICU members, would the Credit Union National Association (CUNA) or the state trade associations assess extra dues to pay this TCCUSF expense? What about CUSOs or CUNA Mutual voluntarily adding to their expenses or surcharging their customers to pay their fair share? If I was a stakeholder in any of these non FICU organizations that were members of a corporate credit union and they "voluntarily gifted" the NCUA – they would be certain to loudly hear about it at the next annual meeting if not also in court. The obvious solution for any non FICU to avoid this "voluntary payment" is to not be a member of a corporate credit union following the promulgation of this rule – perhaps that is the NCUA Board's true intent.

On the other hand, how easy or hard will the NCUA make it for a non FICU member to leave its corporate credit union? Apparently the NCUA Board would not make this rule retroactive on past TCCUSF assessments, but it would apply to future ones. I wonder how many non FICUs there are in corporate credit unions and how many of those are American Share Insurance (ASI) affiliated retail credit unions? Also, how is membership going to be defined and applied by the agency for this rule? If a non FICU had all of its contributed capital depleted and is currently served by a conserved bridge corporate will it be considered a member for the purpose of this "equitably distributed expense?" Can a non FICU simply declare itself a non member of a healthier corporate even though it cannot withdraw its required contributed capital? Since the notice provisions for withdrawal of membership contributed capital are measured in years, are all non FICUs that were corporate members being held captive and subject to the TCCUSF voluntary assessment whether they want to be or not?

Thinly disguised Attempt to Demonize Non FICUs

This proposal also appears to be a thinly disguised attempt to demonize the 150 or so retail credit unions that use ASI as their primary deposit insurer. The NCUA Board appears to want to punish these credit unions after the fact for merely exercising their right to make business choices. Also, how many of these ASI credit unions were members of a corporate credit union and did they even have any deposits there when the NCUA Board stepped in with its stabilization efforts? It was the NCUA Board that declared the corporate credit unions too-big-to-fail and chose to stabilize the corporate credit union system rather than allow the depositors to take their lumps. The reason many of those ASI-insured credit unions were not federally insured was that they did not trust the NCUA Board to make appropriate judgments affecting their businesses – a belief confirmed by this jaw-dropping voluntary payment concept.

And the mandated expulsion vote borders on a public pillorying characteristic of puritanical colonial times – more suitable for drunkards and witches than for responsibly-governed financial institutions. One might also speculate what other "voluntary payments" credit unions and non FICUs could make. How about a voluntary fair share income tax payment to the U.S. Treasury to reduce the deficit? What about an equitable sharing of interchange fees with merchants? Or perhaps credit unions could voluntarily pay for their new consumer compliance regulations by sending a check to the Federal Reserve to pass along to the Consumer Financial Protection Bureau (CFPB)?

One can always hope that the NCUA Board comes to its senses prior to promulgating this ill-conceived new rule in final form. At best this proposal represents misplaced zeal and at worst it is yet another illustration of NCUA's bureaucratic oft-demonstrated bent toward arbitrary and capricious rulemaking. The NCUA Board has initiated a number of responsible actions in its effort to mitigate the corporate credit union crisis – but this isn't one of them. The very notion that this is an "equitable sharing" is incredulous and the worst form of spin-doctoring. Proposed new §704.21 should not be promulgated.

New Proposed Corporate Credit Union Rules Don't Eliminate Uncertainty

The NCUA Board wrote that they were proposing this subsequent set of corporate credit union rules because…"These proposed amendments follow the recent final amendments to part 704 and, like those amendments, will further strengthen individual corporates and the corporate system as a whole." When a rule as big as the one adopted in September 2010 is promulgated, it is not that unusual for it to get tweaked later – although this was awfully soon to be doing so. I would prefer to believe that the NCUA Board was well intended and that what they have stated publicly about their intent for the corporate credit unions was correct – even if occasionally misguided. However, the NCUA Board continued to take contradicting actions that undermined this faith.

The apparent never-ending corporate credit union rule promulgation does inject some uncertainty into the situation and concerns expressed by many within the industry about NCUA leaders just doing what they want whenever they want are valid with any regulation the NCUA Board promulgates. As demonstrated by the many new rules, the NCUA Board apparently intends for any surviving corporate credit unions to have very narrow missions that are risk-adverse. If the payment systems services weren't so critical to so many mid-sized and small credit unions, some industry analysts speculate that the NCUA Board would just as soon shut down all of the corporate credit unions – but they know if they did so several thousand corporate-dependent retail credit unions would soon close as a cascading result.

I have harbored doubts about the wisdom of re-capitalizing any of the corporate credit unions for quite some time now. Although each surviving corporate credit union's business plan going forward deserves a review, none of them have compellingly touted their new approaches to the situation – and merely stating that "our corporate is not insolvent" isn't much of a sustainable plan. Perhaps the industry might start hearing more about it now that some of the corporate credit union business model unknowns are being re-defined by the NCUA Board. I was also puzzled by the NCUA's extension through March 2011 for corporate credit unions to file their business plans with the agency. According to the industry grapevine speculation, the most likely reason for such a move was that corporate credit union executives were having a hard time garnering the needed contributed capital commitments from retail credit unions.

Corporate Credit Unions Firewall Reliant Upon Well-Capitalized Status

One thing that any industry observer should know for sure is that post-2010 corporate credit unions will be entirely new entities and very unlike what they were in the past. It is also clear that even the healthy corporate credit unions would not currently receive the NCUA rules' well-capitalized designation (although they are given ten years to get there – a risky idea in itself.) There remains lingering uncertainty about whether retail credit unions in sufficient numbers would step up and re-capitalize the corporate credit unions to the level that they should be funded in order to provide a "firewall" capital buffer between the corporate credit unions' interconnected structural risk, the NCUSIF, the TCCUSF, and those federally insured credit unions that choose other vendors.

One of the biggest errors that I have observed in 35 years watching the credit union industry is the under-capitalizing and underfunding of almost every venture – whether it is a corporate, a CUSO, or similar initiative. Cheap is not always good and over-leveraging can be downright dangerous. Also, any credit union movement establishment-proposed operation also runs the risk of embedding its interlocking politics into the business plan. These politics add risk to any venture so organized. It is only prudent for retail credit unions to seek alternatives to the corporate credit unions for investment, liquidity, and payment systems services such as the Federal Home Loan Banks, the Federal Reserve System, correspondent banks, etc. The NCUA Board's counterproductive rules are confirming that hypothesis.

These latest corporate credit union rules are a mixed bag, but appear to be a net negative and should be withdrawn – especially new §704.21. The NCUA Board must also press forward with statutory and regulatory reforms to remove the interconnectivity and systemic risks inherent in the credit union industry's deposit insurance structure, capital structure, and antiquated business model. If the NCUA Board Members have questions concerning these comments, please feel free to have then contact me for clarification or elaboration.

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Marvin Umholtz is President & CEO of Umholtz Strategic Planning & Consulting Services based in Olympia, Washington south of Seattle. He is a 35-year credit union industry veteran who has held many leadership positions with credit union organizations and financial services industry vendors during those years. A former association executive and lobbyist, he candidly shares his credit union industry knowledge and analysis with public policy makers, financial industry executives, and vendor companies. Umholtz also helps credit union boards and CEOs with strategic issues like growth, board governance, charter conversions, proactive mergers, voluntary liquidations, regulatory advocacy, and the growing conflict about the future role of credit unions in the financial services industry.